MELVILLE
ANNUAL
REPORT
1973

HIGHLIGHTS	1973	1972 (Restated—Note 4)	Percent Change
Net Sales	**$710,545,140**	$631,917,797	**+12.4**
Earnings before Federal Income Taxes and Minority Interests	**56,364,549**	55,006,236	**+ 2.5**
Net Earnings	**30,605,583**	28,551,722	**+ 7.2**
Dividends on Common Stock	**10,921,553**	9,756,756	**+11.9**
Net Earnings Per Share of Common Stock	**1.23**	1.16	**+ 6.0**
Dividends Per Share of Common Stock	**.445**	.416	**+ 7.0**
Net Earnings as a Percent of Net Sales	**4.31%**	4.52%	
Cash	**15,042,475**	31,141,250	**−51.7**
Inventories	**173,117,954**	130,748,421	**+32.4**
Net Working Capital	**133,457,524**	120,976,122	**+10.3**
Shareholders' Equity	**158,251,029**	137,657,156	**+15.0**
Average Common Shares Outstanding	**24,536,153**	24,405,215	**+ 0.5**
Number of Stores	**2,590**	2,417	**+ 7.2**
Number of Employees	**27,232**	24,386	
Number of Shareholders: approximately 18,100			

MELVILLE SHOE CORPORATION ANNUAL REPORT 1973

Contents

1 President's Report
2 Review of Operations
13 Financial Review
15 Financial Statements
23 Ten Year Financial Summary
24 Accountants' Report
Directors and Officers

PRESIDENT'S REPORT

February 21, 1974

Sales of the Melville Shoe Corporation for 1973 increased 12.4% to $710,545,140 from the 1972 total of $631,917,797. Net earnings, after minority interests, were $30,605,583 as compared to $28,551,722 for 1972, an increase of 7.2%. Earnings per share were $1.23 as compared with $1.16 in 1972. This represents the tenth consecutive year of increase in both sales and earnings. In January, 1974 the dividend was increased to an annual rate of 46.3 cents, the maximum permitted by Federal guidelines.

The year started with Melville and its subsidiaries showing a 16.5% increase in sales and a 29.4% increase in earnings after minority interests, for the first six months. Third quarter progress slowed somewhat with a sales gain of 11.5% and an earnings increase, after minority interests, of 7.7%.

Results for the year, however, were significantly affected by the fourth quarter when sales increased 7.2% while net earnings, after minority interests, decreased 9.5%. In brief, the factors which unfavorably affected us were...

...the general decline in consumer activity;

...unseasonably warm weather which reduced sales of heavy footwear and apparel;

...the spiraling costs of raw materials in the production of footwear, e.g. polyvinylchloride (PVC) and crepe soling, which were not passed on because of Phase 4 and our decision to freeze prices;

...the delay in deliveries of many raw materials that slowed production, causing increased costs.

Two internal factors which adversely affected Melville in 1973 were the additional costs involved in the integration of Clinton Merchandising stores into the Consumer Value Stores division; and a $475,000 write-off, due mainly to the uncollectible receivables, resulting from the discontinuance of the Melcort credit mail-order business.

Thom McAn, Meldisco, and Miles showed gains during the year; and the apparel divisions—Chess King, Foxmoor, and Metro manufacturing—also achieved improved results.

During the year, 315 stores were opened and 142 were closed, increasing the number of units to 2,590 as of December 31, 1973. Three new plants were added to our footwear manufacturing division: a Miller Shoe women's dress and casual unit in Norway, Maine; the recently purchased Dover Shoe plant in Somersworth, New Hampshire, also for the production of women's shoes; and a Blue Ridge Shoe Company boys' plant in Aulander, North Carolina. Metro Pants purchased a men's dress pants factory and constructed a new distribution center in Amory, Mississippi, while opening a new jeans manufacturing plant in Dorsey, Mississippi.

Continuing to develop additional methods of specialty merchandising, we are experimenting through Foxmoor with a small group of discount women's apparel stores called Clothes Bin; and in January 1974 we opened an arts and crafts retail store under the name Melcraft.

During 1974, Melville plans to open approximately 300 new stores and leased departments.

Looking ahead, we see the first six months of 1974 as a challenge. Prospects for the year as a whole appear good, however, as the result of several encouraging factors...

...the removal of price and wage controls, permitting us to pass on additional costs subject to competitive conditions;

...a tighter cost control program instituted at the beginning of the year;

...the expectation that the Fall of 1974 will show a pick-up in the soft goods economy.

Considering the above factors, along with improved merchandise assortments and an aggressive promotional program, we expect Melville to show improvement for the eleventh consecutive year in 1974.

We thank the people of Melville and our suppliers for their continued best efforts on behalf of the Melville Shoe Corporation.

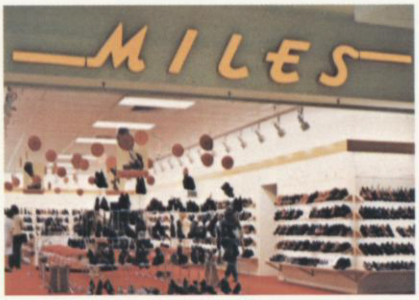
Francis C. Rooney Jr.

Francis C. Rooney, Jr.
President and Chief Executive Officer

Consumer satisfaction through specialty merchandising. As modern consumers have become better educated, informed and more sophisticated in their tastes, their shopping needs, like their lifestyles, have become more varied and individualized. Melville has met these highly specialized demands of the complex new marketplace through the development of specialty retail businesses with sharply defined consumer markets. □ Unlike the average department store, Melville specialty stores concentrate on developing depth and variety within a given product line. Their store formats and merchandising procedures are designed to appeal to customers with similar needs, wants, and tastes. Melville chains, operating under their own names, establish their own identity and appeal in their immediate competitive environment, becoming "the place to go" for their particular merchandising specialty. □ In that they are relatively small and are leased, Melville specialty stores can be established quickly and with a comparatively low initial investment, while producing a maximum return on sales per square foot. The fact that Melville can open as many as a half dozen different types of stores within a single shopping center gives the company a substantially greater sales-impact per center. □ As individualized consumer tastes continue to proliferate, marketing segments will continue to grow into major markets. As a leading specialty merchandiser, Melville is advantageously positioned to grow with them, further expanding its share of the nation's retail business.

Thom McAn, long-time world leader in popular priced men's footwear, has become equally well known as "Thom McAn, the Family Man," the favorite one-stop footwear shopping place for all members of the typical young suburban family. Women's shoes, offered in an increasingly wide variety of styles, are a fast-growing category, while sales of children's shoes, featuring the famed "Five-Way-Fit," continue to expand. The quality, style, and price of Thom McAn footwear have particular appeal to the family market with the price of children's shoes under $10, women's shoes under $15, and men's shoes under $20. ☐ Designed and located for the convenience of its young, active customers, the typical Thom McAn store format in enclosed mall shopping centers represents an open and inviting shopping medium with maximum interior displays. During the past year Thom McAn reduced the depth of its typical Family Store. This moves all departments closer to the mall, thus creating more effective displays and bringing merchandise within easier reach of the customer. ☐ Thom McAn offers customers a unique product manufactured by Melville's J. F. McElwain and Miller Shoe factories. There is a continued effort to improve the quality of all lines of footwear through rigid specification analyses by the Melville Testing Laboratory and a constant monitoring of manufacturing processes. Thom McAn has increased the use of leather in a wide range of women's dress and casual footwear and children's footwear. □ Thom McAn sales staffs are trained to cater to the special individualized wants of customers and are expected to have an extensive and current knowledge of all Thom McAn merchandise lines. As a further means of maintaining a close relationship with its customers, Thom McAn monitors the quality of store service and needs and reactions of its customers on a continuing basis through Customer Response cards mailed directly by the customer to the president of Thom McAn.

Meldisco, Melville's leased self-service department division, with its units located primarily in K-Mart stores, is one of the largest operations of its kind in the footwear industry. Meldisco's specialty merchandising program is directed at the young, value-conscious suburban family with an income in the $10-$15,000 range. Merchandising emphasis is on popularly styled leisure footwear, representing good value at low prices. There is a great depth of line in such categories as heavy work-type shoes worn widely by young people for leisure and everyday wear; sneakers, slippers, and rubber footwear. □ Meldisco departments with wide aisles and large accessible displays are set up to enable entire families to make multi-pair purchases in the least time for the least money. Point-of-sale promotion backed up by major newspaper advertising generates high volume. □ Meldisco's self-service approach encourages customers to sell themselves, thus increasing the number of multi-pair purchases as well as significantly reducing selling costs. High average store volume, low overhead and low margin combine to give the customer greater value than can be found in department stores, conventional shoe stores, or even discount stores that lack Meldisco's volume. ☐ As specialists in promotional high-volume merchandising, Meldisco stresses efficiency in its inventory and distribution operations. A new distribution center is under construction in Atlanta, Ga., to gain further reductions in distribution costs and improve service to Meldisco departments in the Southern region of the United States. Meldisco plans additional new distribution facilities and the further expansion of existing facilities to keep pace with a growth rate of an estimated 100 units a year over the next five years.



Miles, Melville's specialty merchandising division in the women's footwear field, stresses top value at modest prices for the middle-to-low income group as well as the high fashion market. Miles' lines are being continually upgraded with shoes constructed of leather or high-grade polyurethane. During the past year Miles reinstituted its Classical line, an "in with the fashion" grouping of shoes that won immediate customer acceptance and gained a decided fashion advantage over the competition. ☐ In 1973 Miles further expanded the number of its new, highly innovative full-service stores, designed for maximum customer convenience and shopping enjoyment. These stores feature an exciting new color scheme and format with displays that place every available style in a customer's size within her reach. By making it unnecessary for the salesman to bring a mountain of shoe boxes from the stockroom before the customer is satisfied, the new display system saves time and trouble for both customer and salesman, thus increasing efficiency and the quality of customer service.

MELCO SHOES
MELCO SHOES

Melco stores are free-standing, self-service units located along highways and in other areas not served by shopping centers or downtown business sections. Melco's specialty merchandising market is the middle income suburban family that prefers an informal shopping environment and casual footwear. Best-selling Melco lines during 1973 included Dr. Scholl's Exercise Sandals; Converse and Keds sports shoes; Waffle Stompers, a type of hiking boot with heavy treaded sole; and Tyroleans. □ Leisure-type footwear accounts for 60% to 70% of Melco's volume. Prices can be substantially below those of a conventional shoe store. Melco accomplished a considerable amount of upgrading during the past year through the initiation of higher quality standards and an increase in the percentage of imported and brand-name footwear in the merchandise mix. □

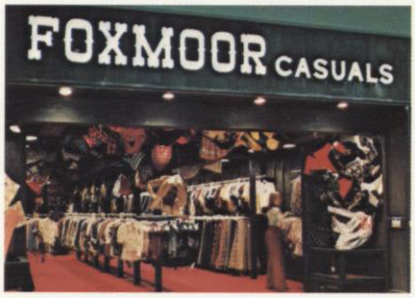
Melco's stores and selling methods are as informal as the merchandise. Customers can walk freely about the store trying on as many pairs as they choose from the 18,000 usually on display; and then take their choices to a supermarket-type check-out counter. Ample parking space and the proximity to population help make Melco easy to shop and easy on the gas tank. Self-service, minimum store personnel, and utilization of EDP systems help hold costs – and prices – down.

vanguard
vanguard

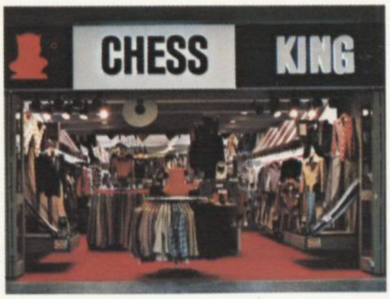
Vanguard is a highly specialized men's footwear operation, offering distinctive merchandise at competitive prices in a personalized shopping environment. Very much attuned to today's casual lifestyles, Vanguard's customers come mainly from the 18-to-29-year-old, middle-to-upper income group. This major specialty market breaks down into several even more sharply defined markets. They include the 18-to-24-year-old who wants to coordinate fashion footwear with the latest fashions; the more traditional customer, the junior management man, married and in his middle to late twenties, who wants fashionable, but not necessarily high fashion, footwear; and the young urban customer who looks for unusual footwear with extreme styling. ☐ The Vanguard sales staff is trained to provide customers with detailed information as to the styling and construction of Vanguard's footwear lines and the nature and kind of leathers used in making them. Vanguard's expanded field supervisory staff conducts regular training sessions on basic selling points as well as the relevancy of footwear styles to current fashion trends. ☐ During the past year, Vanguard lines featured crepe-soled casuals and heavy-leathered, genuine moccasins for the younger customer; updated classics and refined casual slip-ons for the more conservative group as well as a great variety of colorful footwear for the more individualistic customer. Vanguard also offers customers full lines of accessories such as men's jewelry, belts, sunglasses, and imported luggage to complement the chain's footwear.

The Melville Footwear Manufacturing division's output increased by approximately 700,000 pairs, or 5%, in 1973. A new plant for Miller Shoes was opened in Norway, Maine, in February to produce women's dress and casual footwear. Blue Ridge Shoe Company's new plant in Aulander, North Carolina, opened in May to produce boys' dress and casual footwear. The assets of the Dover Shoe Company in Somersworth, New Hampshire, were purchased in December and that plant is operating as the third unit in the Miller Shoes division. Melville Manufacturing now operates nine footwear manufacturing plants in New Hampshire, five in North Carolina, two in Georgia, and one in Maine, Massachusetts, Tennessee, Puerto Rico, and Spain. ☐ Melville's unique manufacturing-retailing relationship provides an unusual sensitivity to consumer trends. Emphasis continues on fast reaction to new and exciting fashion changes and the development of the ability to switch production facilities to the new with a minimum of delay and disruption. □ The functions of Melville's Testing Laboratory have been expanded to include in-factory inspections of products purchased from all resources as well as those manufactured by Melville. All products are laboratory- and wear-tested for quality, performance, and safety. New products or materials are not adopted without laboratory approval.

CVS, Melville's health and beauty aid chain, pioneered in adapting specialty merchandising techniques to its field. CVS provides customers with great depth of line in a given product area – such as toothpaste or hair spray – at prices kept low through the application of modern high-volume buying, distribution, and point-of-sale techniques. Making *convenience* its merchandising watchword, CVS stocks the merchandise customers want the most, promotes it heavily, and makes it easy to buy. CVS stores have clean, neat, well-ordered and well-marked displays, wide aisles, numerous check-out counters, convenient locations, and ample parking space. □ While CVS stores are largely self-service, sales staffs have extensive knowledge of product lines and are trained to provide customers with help where necessary. Staff members are backed up by a toll-free Value Line, used by customers to call in their requests, suggestions, complaints, and comments. Customer service has been further improved through more extensive use of EDP facilities. ☐ The development of CVS's own private label program makes even more quality products available at even lower prices. The successful introduction of prescription drug and other special sections, such as card, household, and large cosmetic units, has not only expanded sales and services but makes it possible to orient the resources of a given store to meet the specific needs of the neighborhood it serves.



Foxmoor Casuals are specialty merchandisers for the 15-to-24-year-old, middle income women's apparel market. Mostly students, or career girls, Foxmoor's customers are interested in style first, then fit, price and quality. Emphasizing a "total look" approach, Foxmoor provides a choice in depth of such currently popular items as pants and tops along with accessories, long dresses, and outerwear complementing the casual sportswear style of the basic garments. During 1973 Foxmoor capitalized on the phenomenal demand for blue denim jeans, selling the material in nearly every style. Foxmoor also successfully imported knit tops and blouses from several European countries, India, and the Orient. Foxmoor scored a fashion beat with another best-selling item, gauze shirts. To keep up with trends Foxmoor buyers regularly visit the world's fashion markets. □ Designed in keeping with their customers' casual lifestyle, Foxmoor's immediately identifiable stores feature a rustic, casual decor. Innovative "hanging trapezes" provide effective, eye-catching displays. Popular background music further contributes to the establishment of a relaxed shopping environment.



Chess King, one of the first young men's apparel specialty merchandising chains when started by Melville in 1968, is a leader in its field. The typical Chess King customer is the 15-to-25-year-old male, usually earning his own money and spending a considerable amount on fashion apparel in keeping with the latest youth lifestyle. As male-oriented as it is, Chess King is also proving exceedingly popular with girls in the 15-to-22-year age bracket. As differences in male-female fashions have diminished, the percentage of Chess King's female customers has increased to 30%. □ Chess King merchandise lines feature the newest and best-selling lines of youth-oriented apparel at popular prices. Screw-driver or buckle-back pants; pre-faded blue denim ensembles; short leather jackets; sport coats with elastic waistbands and pleated backs; coordinated pants and jackets for dress-up or informal wear; sparkle and glitter shirts with sequins, pants, jackets, and knit play-tops are representative of the categories of apparel Chess King merchandises with continuing success. ☐ Featuring bold, bright decor, unusual interior construction such as ramps and ladders, and convertible fixtures that make it possible to hang or fold merchandise, Chess King stores have a unique character that appeals to young people and makes shopping an experience. Chess King sales staffs, many of whom are as young as the customers, learn to provide personalized service through a training program known as Sell the Senses, which is taught using film, tape, and teaching machines.

Melville's Apparel Manufacturing division includes Metro Pants, which manufactures pants for boys and teens, and Spotwood, which manufactures pants for men. Both companies are among the leaders in their field and supply apparel to national retailers, as well as to some Melville divisions. During the year the division strengthened its operations within its specialty through the purchase of a men's dress pants factory in Amory, Mississippi, and the construction of a new distribution center at the same location. A new jeans manufacturing plant was opened in Dorsey, Mississippi, adding much needed production capacity in this apparel category. Metro also initiated the development of EDP operations during 1973 with the purchase of a computer and, earlier this year, moved into a new showroom and offices in New York City.

Financial Review

Earnings

Consolidated net earnings, after minority interests, increased for the tenth consecutive year to $30,605,583 for the year 1973, an increase of $2,053,861 or 7.2% over the $28,551,722 reported for 1972.

Earnings per common share increased to $1.23 for the year 1973, compared to $1.16 for 1972, an increase of 6.0%.

Sales

Consolidated net sales reached a new high for 1973 amounting to $710,545,140, as compared to $631,917,797 a year ago, an increase of 12.4%.

Dividends

During the year 1973, the Company paid a dividend of $.44504 per share. The quarterly dividend on common stock was increased to $.11571 per share in January, 1974. On an annual basis, the quarterly dividend amounts to $.46284 per share, which is the maximum permitted under Federal guidelines.

Property, Plant and Equipment

Capital additions for the year 1973 amounted to $24,285,970 as compared to $17,785,127 in 1972.

Depreciation charged for the year 1973 was $10,913,557 and $9,308,816 in 1972.

Sales by Division

	Sales (000's omitted)			Number of Stores		
	1973	1972	Percent Change	1973	1972	Percent Change
Footwear						
Thom McAn	**$244,685**	$228,142	**+ 7.3**	**1,033**	996	+ 3.7
Meldisco	**211,284**	188,918	**+11.8**	**639**	602	+ 6.1
Miles	**39,970**	38,993	**+ 2.5**	**208**	236	− 11.9
Melco	**5,927**	4,190	**+41.5**	**28**	19	+ 47.4
Vanguard	**3,369**	1,963	**+71.6**	**35**	13	+169.2
McElwain*	**2,102**	1,754	**+19.8**	—	—	—
Spain*	**1,057**	779	**+35.7**	—	—	—
Total Footwear	**$508,394**	$464,739	**+ 9.4**	**1,943**	1,866	+ 4.1
Non-Footwear						
CVS	**$ 97,135**	$ 82,780	**+17.3**	**220**	203	+ 8.4
Chess King	**42,006**	34,053	**+23.4**	**204**	172	+ 18.6
Foxmoor	**45,195**	33,424	**+35.2**	**223**	176	+ 26.7
Metro*	**17,815**	16,922	**+ 5.3**	—	—	—
Total Non-Footwear	**202,151**	167,179	**+20.9**	**647**	551	+ 17.4
Total MSC	**$710,545**	$631,918	**+12.4**	**2,590**	2,417	+ 7.2

*Excludes interdivisional sales of $91,237 in 1973 and $86,145 in 1972 (000's omitted).

Distribution of Sales Revenue

	1973	1972 (Restated—Note 4)
Received from the sale of products	**$710,545,140**	$631,917,797
Paid for materials, merchandise and all expenses, exclusive of taxes and other amounts paid to or for the benefit of employees	**505,384,163**	444,234,577
Remainder	**205,160,977**	187,683,220
This was divided as follows:		
Wages and compensation	**129,712,891**	116,508,537
Taxes	**41,759,537**	40,170,447
Minority interests	**3,082,966**	2,452,514
Paid to shareholders or retained in the business	**30,605,583**	28,551,722

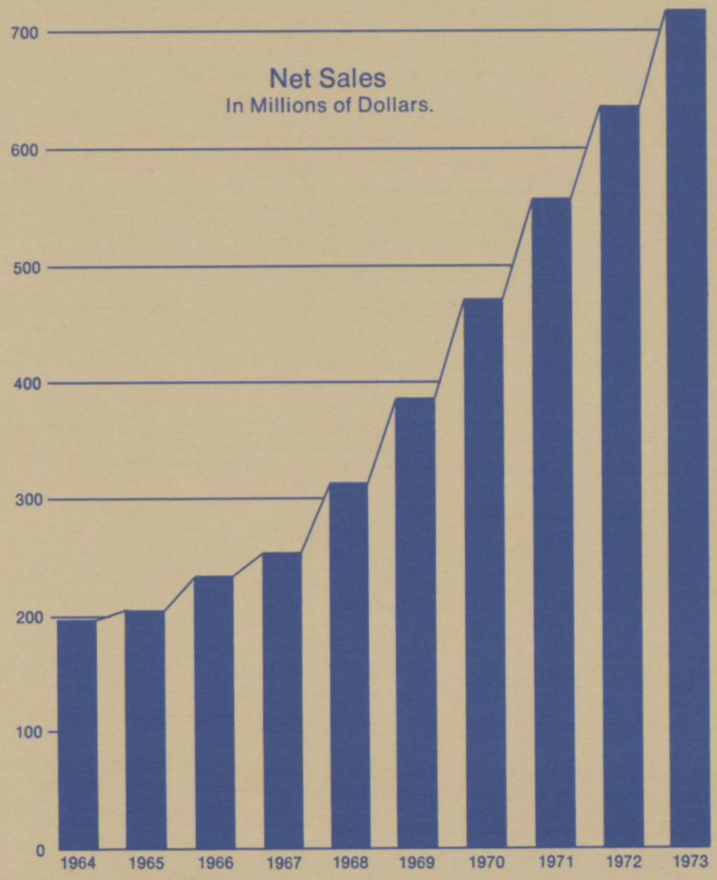
Store Expansion by Division

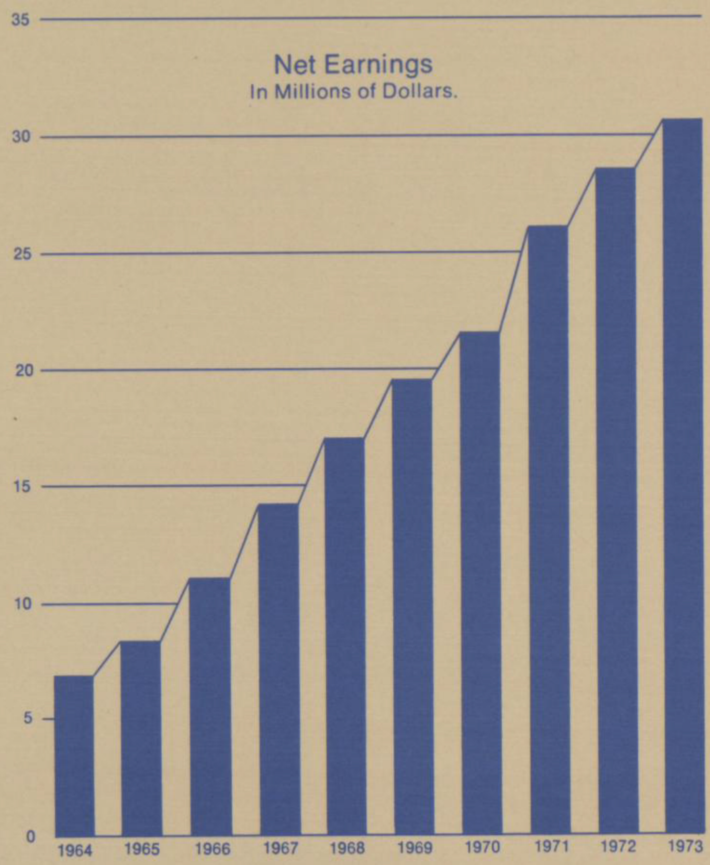
	1973			1974 (Estimated)		
	OPEN	CLOSE	END	OPEN	CLOSE	END
Thom McAn	73	36	1,033	61	26	1,068
Meldisco	89	52	639	95	36	698
Miles	12	40	208	5	7	206
Melco	9	—	28	1	—	29
Vanguard	22	—	35	15	—	50
CVS	23	6	220	35	9	246
Chess King	35	3	204	40	—	244
Foxmoor	52	5	223	40	—	263
Melcraft	—	—	—	2	—	2
TOTAL	315	142	2,590	294	78	2,806

Statement of Consolidated Earnings

Years ended December 31, 1973 and 1972	1973	1972 (Restated—Note 4)
Net sales	**$710,545,140**	$631,917,797
Cost of goods sold, buying and warehousing costs	**415,679,261**	370,278,649
	294,865,879	261,639,148
Store operating, selling, general and administrative expenses	**224,625,523**	195,576,790
Depreciation and amortization	**10,913,557**	9,308,816
Interest charges	**3,696,459**	2,755,011
	239,235,539	207,640,617
	55,630,340	53,998,531
Other income—net	**734,209**	1,007,705
Earnings before Federal income taxes and minority interests	**56,364,549**	55,006,236
Provision for Federal income taxes (notes 1, 4 & 9)	**22,676,000**	24,002,000
	33,688,549	31,004,236
Minority interests in net earnings	**3,082,966**	2,452,514
Net earnings	**$ 30,605,583**	$ 28,551,722
Net earnings per share—common stock (notes 1, 4 & 9)	**$ 1.23**	$ 1.16

See accompanying notes to consolidated financial statements.





Consolidated Balance Sheets

as of December 31, 1973 and 1972	1973	1972 (Restated—Note 4)
Assets		
Current assets:		
Cash	**$ 15,042,475**	$ 31,141,250
Accounts receivable, less allowance for doubtful accounts	**17,041,363**	19,951,692
Inventories (note 1)	**173,117,954**	130,748,421
Prepaid expenses	**3,061,047**	3,166,607
Total current assets	**208,262,839**	185,007,970
Property, plant, equipment and leasehold improvements, at cost (notes 1 & 3):		
Land	**2,653,696**	2,466,757
Buildings	**12,229,103**	7,911,978
Machinery and equipment	**10,675,590**	9,089,301
Store and office fixtures, improvements to leased properties and miscellaneous equipment	**111,358,435**	98,427,291
	136,916,824	117,895,327
Less accumulated depreciation and amortization	**60,332,378**	53,074,297
Net property, plant, equipment and leasehold improvements	**76,584,446**	64,821,030
Deferred charges and other assets (note 3)	**3,160,224**	3,548,845
	$288,007,509	$253,377,845

See accompanying notes to consolidated financial statements.

	1973	1972 (Restated—Note 4)
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	**$ 71,227,866**	$ 52,724,871
Federal income taxes (notes 1, 4 & 9)	**2,870,144**	10,735,420
Current installments on long-term debt (note 5)	**707,305**	571,557
Total current liabilities	**74,805,315**	64,031,848
Long-term debt (note 5)	**35,659,427**	34,841,732
Deferred credit (note 1)	**310,450**	440,450
Deferred credit on condemnation of property (note 3)	**6,620,000**	6,620,000
Deferred Federal income taxes (notes 1 & 9)	**1,994,007**	1,188,194
Lease obligations for closed stores	**658,655**	914,530
Minority interests in subsidiaries	**9,708,626**	7,683,935
Shareholders' Equity (notes 5, 6 & 7):		
Preferred stock, Series B, $4.00 dividend, par value $100, redeemable at par plus accrued dividends; authorized 192,244 shares; issued 88,894 shares in 1973 and 1972	**8,889,400**	8,889,400
Common stock, par value $1.00, authorized 30,000,000 shares; issued and outstanding 24,552,311 in 1973 and 24,442,311 in 1972	**24,552,311**	24,442,311
Capital surplus	**5,762,178**	4,119,288
	39,203,889	37,450,999
Retained earnings	**119,841,162**	100,484,517
	159,045,051	137,935,516
Less cost of preferred shares in treasury (11,267 shares in 1973, and 4,000 shares in 1972)	**794,022**	278,360
	158,251,029	137,657,156
	$288,007,509	$253,377,845

Commitments and contingencies (notes 5 and 8)

Consolidated Statements of Shareholders' Equity

Years ended December 31, 1973 and 1972

	Series B Cumulative Preferred Stock	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock
Balance at December 31, 1971:					
As previously reported	$9,204,400	$12,640,247	$13,934,038	$ 84,246,359	$(200,765)
Federal income tax settlement	—	—	—	(2,339,000)	—
As restated (note 4)	9,204,400	12,640,247	13,934,038	81,907,359	(200,765)
Net Earnings				28,551,722	
Purchase of Series B preferred shares for treasury (4,030 shares)					(280,243)
Cancellation of Series B preferred shares in treasury (3,150 shares)	(315,000)		112,352		202,648
Dividends					
Series B preferred ($4.00 per share)				(348,388)	
Common ($.416 per share)				(9,756,756)	
Exercise of stock options (112,088 shares)		112,088	1,489,444		
Transactions of pooled companies prior to acquisition			273,430	130,580	
Two-for-one common stock split		11,689,976	(11,689,976)		
Balance at December 31, 1972	$8,889,400	$24,442,311	$ 4,119,288	$100,484,517	$(278,360)
Net Earnings				30,605,583	
Purchase of Series B preferred shares for treasury (7,267 shares)					(515,662)
Dividends					
Series B preferred ($4.00 per share)				(327,385)	
Common ($.445 per share)				(10,921,553)	
Exercise of stock options (110,000 shares)		110,000	1,642,890		
Balance at December 31, 1973	$8,889,400	$24,552,311	$ 5,762,178	$119,841,162	$(794,022)

See accompanying notes to consolidated financial statements.

Statement of Changes in Consolidated Financial Position

Years ended December 31, 1973 and 1972	1973	1972 (Restated—Note 4)
Source of Funds:		
Net earnings	$30,605,583	$28,551,722
Expenses not requiring outlay of working capital:		
Depreciation and amortization	10,913,557	9,308,816
Minority interests in net earnings	3,082,966	2,452,514
Increase (decrease) in deferred Federal income taxes	805,813	(1,065,757)
	14,802,336	10,695,573
Working capital provided from operations	45,407,919	39,247,295
Increase in long-term debt	2,125,000	—
Proceeds from sale of common stock under stock option plans	1,752,890	1,601,532
Dispositions of property, plant and equipment	1,608,997	1,999,559
Transactions of pooled companies prior to acquisition	—	404,010
Payments received on condemnation	—	6,620,000
	50,894,806	49,872,396
Application of Funds:		
Additions to property, plant and equipment	24,285,970	17,785,127
Reduction in long-term debt	1,307,305	1,226,716
Increase (decrease) in deferred charges and other assets	(388,621)	1,448,450
Reduction (net) in lease obligations on closed stores	255,875	209,099
Cash dividends paid	11,248,938	10,105,144
Dividends paid to minority interests net of proceeds from sale of subsidiaries' capital stock	1,058,275	714,548
Federal income tax settlement (1964-1971)	—	2,339,000
Purchase of treasury stock-preferred	515,662	280,243
Reduction of deferred credit	130,000	130,000
	38,413,404	34,238,327
Net increase in working capital	$12,481,402	$15,634,069
Net increase in working capital is comprised of:		
Increase (decrease) in current assets:		
Cash	(16,098,775)	(2,943,755)
Accounts receivable	(2,910,329)	6,399,616
Inventories	42,369,533	15,341,301
Prepaid expenses	(105,560)	1,038,174
	23,254,869	19,835,336
Increase (decrease) in current liabilities:		
Accounts payable and accrued expenses	18,502,995	1,802,713
Federal income taxes	(7,865,276)	2,271,517
Current installments on long-term debt	135,748	127,037
	10,773,467	4,201,267
	$12,481,402	$15,634,069

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The consolidated financial statements include the accounts of Melville Shoe Corporation and its subsidiary companies, which are wholly-owned except for an 80% owned foreign manufacturing subsidiary, certain 75% owned retail subsidiaries, and a 55% owned foreign purchasing subsidiary. The total assets and net earnings of the two foreign subsidiaries are insignificant in relation to the consolidated financial position and results of operations for 1973 and 1972. All intercompany items and transactions have been eliminated.

Inventories: Consolidated inventories are valued at the lower of cost or market, based primarily on the retail inventory method. Approximately 4% are valued on the last-in, first-out (LIFO) method. For the inventories valued at LIFO cost, replacement cost exceeded such LIFO cost at December 31, 1973 by $9,373,387 and at December 31, 1972 by $8,267,563.

Depreciation and Amortization: Depreciation and amortization of plant and equipment are provided for accounting purposes on the straight-line method over the estimated useful lives of the assets. It is the policy of the footwear manufacturing division to charge lasts, dies, and patterns to expense in the year of their purchase.

Maintenance and Repairs: Maintenance expense and repairs are charged directly to the appropriate operating account at the time the expense is incurred. Major renewals or replacements are capitalized after making necessary adjustments in the asset and accumulated depreciation accounts for the items renewed or replaced.

Federal Income Taxes: The Company accounts for the investment tax credit under the flow-thru method for both financial and income tax purposes. Deferred Federal income taxes are provided to reflect the difference in timing of certain transactions for accounting and tax purposes. Such differences arise primarily from depreciation, lease obligations and expenses relative to closed stores, and proceeds and costs relative to the condemnation proceeding.

Pension Plans: The Company and its subsidiaries have several pension plans which cover substantially all of its employees. The provision for pension costs includes amortization of past service costs, less amortization in annual installments to 1978 of a deferred credit representing the amount provided for pensions prior to adoption of funding for all plans. Past service costs are being amortized on a straight-line basis through 1996.

The total of pension funds and amounts accrued for pensions was in excess of the actuarially computed value of vested benefits as of December 31, 1973. Unfunded past service costs at December 31, 1973 aggregated approximately $6,070,417. The Company's provisions under pension plans aggregated $1,605,608 in 1973 and $1,550,795 in 1972.

Earnings Per Share: Earnings per share are computed by dividing net earnings, after deducting preferred dividends, by the average number of common shares outstanding during the year, as adjusted for stock splits and shares issued in poolings of interests transactions. The conversion of the Convertible Subordinated Debentures and exercise of the outstanding stock options would not result in dilution of earnings per share in 1973 and 1972.

Store Opening and Closing Costs: The Company follows the practice of charging new store opening costs against earnings as incurred. In the event a store is closed before its lease has expired, the total lease obligation, if any, less sub-rental income is provided for in the year of closing.

(2) ACQUISITIONS

In December, 1972, the Company acquired Metro Pants Company, Inc. and its affiliated companies, a manufacturer and wholesaler of boys' and young men's pants, and Clinton Merchandising, Inc., a chain of retail drug and health and beauty aid stores, for 284,000 and 666,271 shares of common stock, respectively. Each transaction was accounted for as a pooling of interests in 1972 and prior year consolidated financial statements were restated to reflect such acquisitions.

(3) PROPERTY, PLANT, AND EQUIPMENT

Pursuant to an order of condemnation, a subsidiary of the Company was compelled to surrender possession of certain land and building on April 20, 1971. The subsidiary has recorded as a deferred credit, $6,620,000 in payments it received in 1972 toward the final award. Relocation and related expenses incurred by the Company have been deferred and will be applied to the proceeds of the final award which is currently pending. In the opinion of management, the Company will not sustain a loss on the disposition of these assets.

(4) SETTLEMENT OF FEDERAL TAX EXAMINATION

The Internal Revenue Service has completed its examination of the Company's Federal income tax returns for the years 1964 through 1971. Closing agreements were signed in May, 1973, providing for disallowance of certain surtax exemptions and the reallocation of certain income and expenses between the Company and its retail subsidiaries. Accordingly, consolidated financial statements for 1971 and prior years have been restated to reflect additional Federal and state income taxes and related interest aggregating $2,339,000. This amount has been charged to retained earnings at December 31, 1971.

The 1972 consolidated financial statements have been restated to provide for the additional amount of income taxes necessary to reflect the terms of the agreement in that year. This amount, $492,000, reduced earnings per share as previously reported in 1972 by $.02 ($1.18 to $1.16).

(5) LONG-TERM DEBT

Long-term debt at December 31, 1973 and 1972 consisted of the following:

	1973	1972
4⅞% Convertible Subordinated Debentures, due June 1, 1996	$25,000,000	$25,000,000
4⅞% Debentures, due 1980	4,800,000	5,400,000
3½% Promissory Note, payable in quarterly installments through 1984	1,449,000	1,561,000
6¼% Mortgage Notes, payable in monthly installments through 1989	1,379,880	1,435,911
7½% Mortgage Notes, payable in monthly installments through 1999	510,038	524,366
7¼% Note, payable in quarterly installments through 1977	627,619	827,619
6% Mortgage Notes, payable in semi-annual installments through 1992	880,000	—
5-6% Mortgage Notes, payable in semi-annual installments through 1983	800,000	—
Other mortgages and notes payable	920,195	664,393
	36,366,732	35,413,289
Less current installments	(707,305)	(571,557)
	$35,659,427	$34,841,732

The 4⅞% Convertible Subordinated Debentures are convertible into common stock at the option of the holder up to June 1, 1996 at the price of $32 per share, subject to adjustment in certain events. The Debentures are redeemable at the option of the Company at 104.388% of the principal amount on or before May 31, 1974, and thereafter at declining amounts to par. The Indenture provides for the establishment of a sinking fund commencing in 1982.

The Indentures relating to the 4⅞% Convertible Subordinated Debentures due 1996 and the 4⅞% Debentures due 1980 contain provisions for certain restrictions as to payment of cash dividends and retirement of the Company's capital stock. At December 31, 1973, $30,503,002 of the consolidated retained earnings was so restricted.

(6) CAPITAL STOCK

On April 11, 1972, the shareholders approved a two-for-one common stock split and an increase in the authorized shares of $1 par value common stock from 15,000,000 to 30,000,000 shares.

(7) STOCK OPTION PLANS

Stock Option Plan—1964: Under a qualified stock option plan adopted in 1964, options have been granted to key managerial employees, at fair market value on date of grant. The right to exercise such options commences one year from the date of the grant and expires five years after such date. At December 31, 1973, 467,490 shares of common stock were reserved under the plan, options for 438,530 shares were exercisable, and 27,960 shares were available for grant under the plan.

Information with respect to options granted under this plan is as follows:

	Number of Shares	Price Range per Share
Shares under option at December 31		
1972	562,830	$13.94-$37.13
1973	439,530	$13.94-$37.13
Shares which became exercisable during:		
1972	271,000	$28.69
1973	52,200	$29.81-$37.13
Options exercised during:		
1972	112,088	$ 8.55-$28.69
1973	110,000	$13.94-$28.69

Stock Option Plan—1973: On April 10, 1973, the shareholders approved the termination of the Company's Incentive Stock Purchase Plan, thereby restoring 787,580 shares of common stock, previously reserved under the plan, to authorized and unissued shares. On the same date, the shareholders approved the adoption of a Stock Option Plan which provided for the grant of options for a maximum of 300,000 shares of the Company's common stock to corporate officers and other key managerial employees of the Company. The stock options granted under such plan may be designated as either qualified or non-qualified. The right to exercise such options commences one year from the date of grant and expires 10 years after such date. At December 31, 1973, 300,000 shares of common stock were reserved under the plan and 142,750 shares were available for grant under the plan. During 1973 options were granted at fair market value on date of grant.

(8) LEASE RENTALS AND COMMITMENTS

The Company and its subsidiaries lease various plant, warehouse, office, and retail store facilities under lease agreements expiring between 1974 and 2003. In accordance with new disclosure requirements, certain leases have been classified as financing leases.

Minimum Rental Commitments:

Minimum rental commitments under such agreements at December 31, 1973 are as follows:

	Minimum Rentals		Minimum Sub-Rentals	
	Financing	Non-Financing	Financing	Non-Financing
1974	$1,085,994	$28,509,972	$ 1,417	$ 663,033
1975	1,085,994	27,479,791	–	583,735
1976	1,085,994	25,947,083	–	514,488
1977	1,085,994	24,376,013	–	404,527
1978	1,079,994	22,996,503	–	353,710
1979-1983	5,389,885	93,217,959	–	1,241,951
1984-1988	5,176,704	59,239,930	–	554,056
1989-1993	5,064,528	26,185,453	–	124,860
Thereafter	6,078,795	3,231,247	–	74,916

Rental Expense:

Rental expense for 1973 and 1972 is as follows:

	1973		1972	
	Financing	Non-Financing	Financing	Non-Financing
Basic Rentals	$1,082,265	$29,306,432	$1,083,936	$26,592,118
Contingent Rentals	–	29,891,649	5,791	25,867,988
	1,082,265	59,198,081	1,089,727	52,460,106
Sub-Rentals	(8,500)	(840,522)	(8,500)	(441,589)
Total Rentals	$1,073,765	$58,357,559	$1,081,227	$52,018,517

Included in contingent rentals are rentals for leased shoe departments which are based on sales with additional rentals based on profits, if any. The remaining contingent rentals are based only on sales.

The present value of the net minimum lease commitments for financing leases amounted to $11,529,015 as of December 31, 1973 ($11,458,721—December 31, 1972). The present value of sub-rental payments amounting to $1,207 at December 31, 1973 ($7,241—December 31, 1972) have been deducted in arriving at such amounts. The interest rates used to calculate such present values ranged from 4.5% to 10.0%. These rates approximate the interest rates for mortgage borrowings at the time of entering into the various leases. The weighted average interest rate based on present value approximated 7.9% in 1973 and 1972.

If all financing leases were capitalized and amortized on a straight-line basis, in lieu of charging rentals to earnings as incurred, the effect on net earnings would be less than 1% in 1973 and 1972.

(9) FEDERAL INCOME TAXES

The Company and its subsidiaries have for many years filed separate Federal income tax returns and claimed separate surtax exemptions through 1972. Pursuant to the Tax Reform Act of 1969, surtax exemptions for controlled groups are being phased out over a six-year period which commenced in 1970. Also, as described in note 4, the tax settlement in 1973 with the Internal Revenue Service provided for disallowance of certain surtax exemptions. In calculating its current income tax provision, the Company has determined that it is favorable to file its 1973 tax return on a consolidated basis.

The provision for Federal income taxes includes deferred taxes of $985,000 in 1973 and ($1,308,000) in 1972.

In 1973, Federal income tax expense of $22,676,000 produced an effective tax rate of 40.2%. This effective rate was less than the U.S. statutory income tax rate by 7.8% for the following reasons:

	$	% of pre-tax income
Consolidated Federal Income Tax	$22,676,000	40.2
75% owned subsidiaries not includable in the consolidated Federal income tax return	2,912,000	5.2
Other book/tax differences	1,460,000	2.6
U.S. statutory income tax	$27,048,000	48.0

Ten Year Financial Summary

Melville Shoe Corporation
and subsidiary companies

	1973	1972	1971	1970	1969	1968	1967	1966	1965	1964
Results for the Year (000's omitted)										
Net Sales	**$710,545**	$631,918	$556,062	$468,236	$386,030	$313,456	$258,752	$234,313	$203,545	$195,171
Wages and Compensation	**129,713**	116,509	102,859	91,617	78,457	69,111	57,279	51,827	46,122	44,305
Taxes—All	**41,760**	40,170	33,483	26,628	22,479	19,132	15,385	11,930	9,940	10,220
Earnings Before Federal Income Taxes and Minority Interests	**56,365**	55,006	47,644	38,950	34,601	29,453	23,408	17,633	13,668	12,337
Net Earnings	**30,606**	28,552	25,115	21,545	19,625	17,034	14,305	11,059	8,344	6,953
Dividends Paid	**11,249**	10,105	9,690	9,035	7,657	6,416	4,833	3,922	3,281	2,779
Per Share Results of Common Stock*										
Net Earnings	**$1.23**	$1.16	$1.02	$ .88	$ .81	$ .73	$ .63	$ .48	$ .35	$ .29
Dividends	**.44½**	.41⅗	.40	.37½	.32½	.27½	.20	.15⅝	.12½	.10
Taxes—All	**1.70**	1.65	1.38	1.11	.94	.84	.70	.54	.45	.46
Book Value	**6.12**	5.28	4.46	3.78	3.22	2.64	2.15	1.79	1.52	1.28
End of Year Position (000's omitted)										
Current Assets	**$208,263**	$185,008	$165,173	$127,674	$111,913	$ 91,482	$ 77,352	$ 67,275	$ 61,596	$ 58,702
Current Liabilities	**74,805**	64,032	62,170	56,141	43,043	32,895	26,549	20,644	18,977	17,431
Current Ratio	**2.78**	2.89	2.66	2.27	2.60	2.78	2.91	3.26	3.25	3.37
Property, Plant and Equipment (000's omitted)										
At Cost	**$136,917**	$117,895	$105,816	$ 88,711	$ 73,128	$ 65,128	$ 57,451	$ 53,316	$ 50,361	$ 47,167
Net After Accumulated Depreciation	**76,584**	64,821	58,344	46,006	33,820	26,617	20,893	18,377	17,350	16,030
Capital Additions	**24,286**	17,785	22,383	20,073	14,736	9,059	6,409	4,945	4,971	2,046
Depreciation	**10,914**	9,309	7,769	5,726	4,575	3,950	3,455	3,292	3,148	3,272
Percent to Net Sales										
Earnings Before Federal Income Taxes and Minority Interests	**7.93%**	8.70%	8.57%	8.32%	8.96%	9.40%	9.05%	7.53%	6.72%	6.32%
Net Earnings	**4.31%**	4.52%	4.52%	4.60%	5.08%	5.43%	5.53%	4.72%	4.10%	3.56%
Percent Net Earnings to Shareholders' Equity	**22.23%**	24.30%	24.92%	24.78%	27.79%	29.44%	28.23%	24.24%	19.77%	18.11%
Number of Stores	**2,590**	2,417	2,240	1,973	1,666	1,510	1,366	1,314	1,275	1,250

*Adjusted to reflect two-for-one stock split on April 10, 1968, April 14, 1970, and April 11, 1972.
1971 and prior restated for poolings of interests (note 2).
1972 and prior restated for Federal income tax settlement (note 4).

Accountants' Report

PEAT, MARWICK, MITCHELL & CO.
Certified Public Accountants
345 Park Avenue
New York, New York 10022

To the Board of Directors
and Shareholders
Melville Shoe Corporation:

We have examined the consolidated balance sheets of Melville Shoe Corporation and subsidiary companies at December 31, 1973 and at December 31, 1972, and the related statements of earnings, shareholders' equity, and changes in financial position for each year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of Melville Shoe Corporation and subsidiary companies at December 31, 1973 and at December 31, 1972, and the results of their operations and changes in financial position for each year then ended, in conformity with generally accepted accounting principles applied on a consistent basis, after restatement of prior year figures.

As described in note 4 to the notes to consolidated financial statements, the Internal Revenue Service completed its examination in 1973 of the Company's Federal income tax returns for the years 1964 through 1971. Accordingly, the matter which caused us to issue our reports on the consolidated financial statements of Melville Shoe Corporation for the years 1969 through 1972 subject to the final determination of the Company's Federal income tax liability has been settled and such qualification is no longer required.

Peat, Marwick, Mitchell + Co.

February 21, 1974

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Melville Shoe Corporation, 3000 Westchester Avenue, Harrison, New York 10528

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Assistant Treasurer

Annual Meeting of Shareholders will be held at Melville Corporate Headquarters
3000 Westchester Avenue, Harrison, New York, at 10 a.m., April 9, 1974

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67 Millbrook Street
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Blue Ridge Shoe Company

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Melville (Europe) Purchasing Ltd.

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Villena, Spain

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Managing Director

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3000 Westchester Avenue
Harrison, N.Y. 10528

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Secretary

Assistant Secretaries
GILBERT G. KEMNITZ
JOHN J. RADEMAKER
ARTHUR V. RICHARDS
BERTHA K. SMITH

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New York, N.Y. 10022

Transfer Agent:
Irving Trust Company
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New York, N.Y. 10015

Registrar:
First National City Bank
111 Wall Street
New York, N.Y. 10015